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SUBJECT: DUBAI'S PROPERTY MARKET PART THREE -- BOOM OR BUST?

REF: A) Dubai 3286 Ref B) Dubai 4371

¶1. (SBU) Summary: Dubai's property market has been growing too big, too fast, according to many observers. Others, concerned that currently skyrocketing property prices in Dubai are not good for business, look to the construction surge to assuage this demand. Since the 2002 advent of property sales to foreigners, scores of "freehold" high-rises with thousands of apartments have been put up for sale, often years before they are even built. Insider estimates put the total number of units being constructed at roughly 130,000, and estimate total freehold development announced so far at around USD 50 billion. While there are solid economic trends propelling this market, many insiders believe prices will drop; few, however, are predicting a crash. On average, they estimate a fall of around 20 percent, perhaps two to three years out. This cable, the last in a three-part series on Dubai's freehold property market, looks at the size of the construction boom, the factors propelling it, and the possibility of a slump in prices. Part One of the series (Ref A) looked at the legal status of freehold property, while Part Two (Ref B) looked at who was buying it. End Summary.

Background on Freeholds

¶2. (SBU) Until recently (Ref A), real estate in Dubai could be owned only by UAE and other GCC nationals. The huge foreign population resident in Dubai (foreign residents are estimated to constitute more than 90 percent of Dubai's total population of over one million) had been restricted to renting. (Note: This practice is common in many countries in the region, where there is great sensitivity about selling off the patrimony to outsiders.) In May 2002, the Dubai government gave permission to three companies to develop and sell "freehold" properties to foreigners on government-designated pieces of land. The pro-growth government of cosmopolitan Dubai, recognizing the potentially huge contribution that foreign ownership could make to Dubai's development, viewed the move as a very logical, even essential, next step.

Size of the Boom

13. (SBU) Other GCC countries have also announced large freehold property developments to be sold to foreigners, but Dubai's are on a different scale. The growth in freehold properties in Dubai has been mammoth by any measure, whether looking at the money invested in construction, the dollar amount of total sales, or the number of units being constructed. Aggregate numbers are hard to come by. Perhaps fearing that investors might be nervous if they knew the full magnitude of the construction, or possibly because the pace of new development quickly makes estimates out of date, neither the developers nor the Dubai government makes public any Dubai-wide totals. While all such numbers should be approached with caution, the CEO of a major Dubai developer told PolEconoff recently that some USD 50 billion in freehold property construction was either underway or announced.

14. (SBU) A property surveyor estimated that Dubai freehold announcements so far have totaled about 130,000 units, with only around 8,000 or so of those finished. Property giant Emaar's USD 10 billion Dubai Marina, well underway, is to have a residential capacity of 150,000 (roughly 37,000 units, assuming an average of four family members per unit), and it is sold out. The GM of a prominent golf course, a UAE national, told PolEconoff that the government planned to put 186,000 people (approx. 46,000 units) in the huge projects surrounding his course. Illustrative of the size of the boom (and what most upset this manager) was the phenomenal growth in the number of golf courses in Dubai -- currently six, but slated to be 20.

15. (SBU) Dubai has grown quickly and so far very successfully with a "build it and they will come" mentality, and the property market is no exception. Many people believe, however, that this time Dubai has gone too far, too fast. Two questions heard frequently around town are: Will the demand for freehold property be strong enough to match the huge supply that is currently in train, justifying the massive investment? And if the prices do go down, when it will happen and to what extent?

Pro: Solid Reasons Behind Freehold Growth

16. (SBU) Proponents of Dubai freeholds cite several reasons for their confidence in Dubai's trajectory. Some of these are systemic factors not specifically derived from the property market but boosting it nonetheless. First, Dubai is a cosmopolitan city and, by most accounts, the most desirable place to live in the Gulf. The UAE is politically stable, and its economy, particularly in Dubai, is growing quickly. Dubai's allure also derives from its tax-free environment. Oil prices are high and the GCC, particularly since 9/11, prefers to keep more of its money close to home. As Simon Azzam, CEO of local property developer Union Properties, recently told the Gulf News, "Dubai is one of the fastest growing cities in the world."

With an official population of a little over a million, press reports abound that Dubai expects its population to double by 2010 (around 15 percent growth per year). If that estimate were to hold true, the number of freehold units mentioned in para three could actually be insufficient.

17. (SBU) In addition to favorable macroeconomic considerations, real estate "bulls" in Dubai point to several factors endemic to Dubai's property market. Current demand is so high that apartment rents across the city have been increasing dramatically. Even hotel occupancy rates are at an all-time high. A.J. Jaganathan, CEO of Dubai developer Emaar, told the Khaleej Times that, "Dubai has an expatriate population with (freehold) purchasing capability of about 300,000. Of them, about 30,000-35,000 (i.e. only some 10 percent) have bought property so far. At the same time, the population of Dubai in the income bracket that could buy is growing at about four to five percent, although the total growth rate is much higher."

18. (SBU) Another reason to believe that property prices are likely to remain strong despite rising supply is that Dubai has so far not introduced its new property regulations. The resultant hazy legal environment of buying a freehold has scared

many potential investors away (Ref A). Once the new laws are promulgated and working smoothly, these risk-averse expats will likely be much more willing to buy. Furthermore, without the proper legal infrastructure, the mortgage market for Dubai's freeholds is for the most part untapped; as it develops and expands, customers will be able to buy more easily, and the freehold market as a whole will become more liquid and mature.

Con: Why Freehold Prices Might Drop

¶9. (SBU) Despite all of the solid reasons for the size and pace of Dubai's freehold frenzy, many observers believe current prices cannot be sustained. Even Sultan bin Sulayem, Chairman of Dubai's property giant Emaar, predicted to a local newspaper on December 8 that Dubai's property market would "cool down." Sulayem, also a top official in the Dubai government, said, "...it is not in Dubai's interest to have such high prices for real estate." The head of a British bank predicted to PolEconoff recently that "supply will outstrip demand," and the Emirati head of a local bank, noting that there were "too many properties under construction" wondered, "Who will live in all these?"

¶10. (SBU) People predicting a fall in prices cite several concerns. Most importantly, they believe that the forces fueling freehold growth have already been factored (or perhaps over-factored) into the price. It is this optimism that has caused so much speculation. Indeed, 70 to 80 percent or more of freehold sales have been to speculators and to other investors who will not, ultimately, reside in the properties they have bought. The Dubai government has recently become more aware of the danger of such rampant property speculation and introduced rules -- or pushed developers to introduce rules -- to slow down this trend. Buyers of units in many of the newest projects have had to sign a contract that precludes onward sales for a period of two years. Owners of apartments in the Jumeirah Beach Residence have been told that the fee to transfer the "title" (actually just a contractual obligation until they are built and registered) would be seven percent of the market price of units currently for sale.

¶11. (SBU) Pessimists also point out that, as mentioned in para 3, of the 130,000 freehold units to be built, less than 10 percent have been completed. Even in the finished tower blocks of Dubai Marina, which have all sold out, only about 15 percent appear to be occupied. As each project is completed, speculators who have not already unloaded their properties will have to either find renters, sell, or keep them vacant in hopes of appreciation. Moreover, Dubai residents who do physically move into new projects are leaving behind vacant apartments. As this trend accelerates, it could lead to falling rental prices, which could in turn drag down purchase prices.

¶12. (SBU) A final reason sometimes cited for pessimism in the property market is related to construction quality. Buying based on a blueprint, and without a chance to "kick the tires," purchasers have taken the developers at their word. But many insiders have expressed grave concern about how well these places are being built. An article soon to be published by Dow Jones Newswires, for example, documents the problems in Emaar's Garden View villas, where residents of 100 villas were recently moved out of one area because of shoddy construction. (Note: These residents actually got a windfall, as they were given nicer and more expensive houses in a nearby development.) An expat site manager of a construction team told PolEconoff that he guessed many of these units would last for 10 years, but that after that many might no longer be livable. The GM of a local bank, talking about how construction firms had been cutting corners in the face of the rising cost of materials, said he could not see offering 20-year mortgages on places that would likely be falling apart in 10 years. (Note: Fifteen-year mortgages of 70 percent are quickly becoming the norm.) Dubai's media, while doing a good job of hyping the property market, has reported practically no stories about poor building quality; once this information becomes widely disseminated, some insiders believe, prices are bound to fall.

Crash or Soft Landing?

¶13. (SBU) On average, the property "bears" seem to think that freehold prices in two or three years will be around 20 percent less than they are today. The CEO of one large developer told us that three corrections were coming, the first in the beginning of 2006 (scheduled completion of Palm Jumeirah) and then two more corresponding with the completion of other massive developments. He thought the combined effect would be a drop of 10 to 20 percent, but that the market would not crash -- though he still predicted that some speculators would be "left holding the bag." The GM of a local bank predicted, "In four to five years there will be a crunch," while the head of another bank thought that "the market will be safe for two to three years, then there will be a slump." In fact, the market may be already starting to lose a little steam; while the premiums on properties (the amount the properties have appreciated since they were first sold) are still very high, there are some reports that these premiums have dropped a bit of late (Ref B).

Comment

¶14. (SBU) The sheer magnitude of the freehold property construction boom in Dubai is striking. With investors willing to keep bankrolling new projects, Dubai has a strong incentive to come up with new multi-billion dollar developments to offer them. As strong as the underlying factors propelling this frenzy of activity are, the possibility of a fall in prices seems real. The Dubai government appears fully cognizant of the risks of a property crash and has taken steps to decrease speculation. Indeed, a controlled slide in property prices and rents could prove to be better for business than escalating prices have been. Looking at the larger picture, allowing expatriates to buy homes will slow down the repatriation of Dubai-created wealth, enhance Dubai's economic base, and create more "buy in" from Dubai's expatriates.

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